No. 93-489 (11)

In The
Supreme Court of the United States
October Term, 1993

O'Melveny & Myers,
a Law Partnership,
Petitioner,
v.

Federal Deposit Insurance Corporation as Receiver for American Diversified Savings Bank, ADC Financial Corporation, American Diversified/Wells Park II, and American Diversified/Gateway Center,
Respondents.

On Writ of Certiorari to the
United States Court of Appeals
for the Ninth Circuit

BRIEF FOR PETITIONER

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QUESTIONS PRESENTED

1. Whether 12 U.S.C. § 1821(d)(2)(A)(i), which provides that the Federal Deposit Insurance Corporation (FDIC) as receiver succeeds to the rights of a failed savings and loan, precludes judicial promulgation of a uniform federal rule of decision that eliminates requirements under applicable state law for a valid claim by the savings and loan against a former outside attorney.

2. Whether under *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715 (1979), it is proper to create a uniform federal rule of decision to determine the defenses to a state-law tort claim brought by a receiver for a savings and loan against a former outside attorney to the savings and loan.

TABLE OF CONTENTS

TABLE OF CONTENTS—Continued

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

BRIEF FOR PETITIONER

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-16a) is reported at 969 F.2d 744. The decision of the United States District Court for the Central District of California (Pet. App. 18a-19a) is not reported.

JURISDICTION

The court of appeals issued its decision on June 29, 1992. A timely petition for rehearing was denied on June 30, 1993. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

12 U.S.C. § 1821(d)(2)(A)(i):

> Powers and duties of Corporation as conservator or receiver. (2) General powers. (A) Successor to institution. The Corporation shall, as conservator or receiver, and by operation of law, succeed to—
>
> > (i) all rights, titles, powers, and privileges of the insured depository institution, and of any stockholder, member, accountholder, depositor, officer, or director of such institution with respect to the institution and the assets of the institution.

STATEMENT OF THE CASE

This case presents for review the unprecedented ruling of the Ninth Circuit that, when the FDIC as receiver for a failed savings and loan sues a lawyer for alleged malpractice, the lawyer may not base a defense on the knowledge and wrongdoing of the client's owners and controlling officers and directors, or even of the client itself. Petitioner, the law firm of O'Melveny & Myers, provided legal services to American Diversified Savings Bank (ADSB) between late September and December 1985.[1]

[1] This statement is based on a set of facts to which the petitioner stipulated solely to test the legal validity of the FDIC's tort claims. The stipulation was prepared prior to any formal discovery by

During this three-month period, petitioner assisted in the preparation of two "Private Placement Memoranda" (PPMs) that ADSB used in soliciting investments in real estate syndications. Less than two months after these transactions closed, the Federal Home Loan Bank Board (FHLBB) declared ADSB insolvent and appointed the Federal Savings and Loan Insurance Corporation (FSLIC) conservator and later receiver for the thrift. Thereafter, the FSLIC caused ADSB and its subsidiaries to rescind the offerings and to return to the investors all sums invested, plus interest, in return for recovery of the syndicated real estate. Over two years later, the FSLIC brought this action to recover the out-of-pocket expenses of ADSB and its subsidiaries incurred in connection with the two transactions. Pet. App. 15a.[2]

At the time ADSB retained petitioner, ADSB's principal officers and directors and sole shareholders were engaged in an extensive campaign of fraud to hide the thrift's insolvency and to avoid take-over by federal and state regulators. Stip. ¶ 71. This campaign was orchestrated by Ranbir Sahni, ADSB's Chairman and Chief Executive Officer, and Lester Day, ADSB's President. As owners of, respectively, 96% and 4% of ADSB's stock, Sahni and Day completely controlled and dominated the institution.[3]

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petitioner. Petitioner would contest many of the facts included in the stipulation at the behest of the FDIC in the event of further proceedings. Citations are to the Stipulation ("Stip. ¶") and attached exhibits, which appear in the Excerpts of Record ("E.R.").

[2] Following passage of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, 103 Stat. 183, the FDIC assumed FSLIC's responsibilities and was substituted as a party to this action.

[3] In a related proceeding, the FDIC explained that

> Sahni and Day were in complete control of the day-to-day operations of ADSB and its subsidiaries. They appointed all of the corporate officers. Sahni initiated almost all commercial loans, and only Sahni and Day could approve such loans. Day had to sign off on all real estate deals. . . .

Together with ADSB's Executive Vice President, Wyn Pope, Sahni and Day "intentionally and fraudulently overvalued ADSB's assets, engaged in sham sales of assets in order to create inflated 'profits,' and generally 'cook[ed] the books.'" Pet. App. 3a.

To facilitate this deceit, Sahni and Day also fired or replaced ADSB's accountants and lawyers when, after many months, those professionals began to learn of the institution's true financial condition. The successor firms (such as petitioner) were told that their predecessors had been too expensive for further work. Sahni and Day also concealed from the dismissed or outgoing firms the fact that ADSB was proceeding with new real estate transactions prepared by new accountants or lawyers. Petitioner was the last firm unwittingly drawn into this scheme, which ended less than five months after petitioner was retained, when federal regulators closed ADSB.

1. The Growth Of ADSB

Ranbir Sahni purchased Tokay Savings and Loan Association, a small California-chartered thrift, in June 1983 and, after renaming it, rapidly transformed the institution. Within two years, ADSB ranked 230th nationally among thrifts in deposits and 257th in assets. Stip. ¶ 98. ADSB's principal activity under Sahni's control was the purchase, development and sale of real estate through limited partnerships sponsored by its wholly owned subsidiaries. Pet. App. 2a.

Growth such as ADSB's was common during the mid-1980s, and indeed was encouraged by federal legislation enacted earlier in the decade. With the high interest rates of the late 1970s and early 1980s, thrifts had been increasingly unable to compete for funds due to regulatory limits on the interest they could pay on deposits. See H.R.

> In short, every important decision made on behalf of ADSB or its subsidiaries had to be known and approved by either Sahni or Day.

Brief for Appellants at 8-9, *California Unions Ins. Co.* v. *American Diversified Sav. Bank*, 948 F.2d 556 (9th Cir. 1991) (No. 89-55843).

Rep. No. 54(I), 101st Cong., 1st Sess. 294-97 (1989). Congress responded by passing the Depository Institutions Deregulation and Monetary Control Act of 1980, which phased out interest rate caps on deposits, raised deposit insurance coverage from $40,000 to $100,000, and authorized thrifts to offer Negotiable Order of Withdrawal, or NOW, accounts. *Id.* at 295.

Although these changes enabled thrifts to attract depositors, they were forced to pay higher rates on deposits than they were collecting on their traditional long-term, low-yielding mortgage loans. *Id.* at 296. By 1982, this "interest squeeze" had caused more than 300 depository institutions to fail. *Id.* Congress addressed this problem in the Garn-St Germain Depository Institutions Act of 1982, which "gave thrifts far greater flexibility in deciding how their money could be invested." *Id.* at 297. ADSB was one of the "hundreds" of thrifts that "wasted little time in taking advantage of the expanded opportunities, capabilities, and incentives" that the new law provided. L. White, *The S&L Debacle* 99 (1991). Indeed, ADSB's investments were typical of a trend that led to a tripling of the "nontraditional" assets held by thrifts between 1982 and 1985. *Id.* at 102.

2. ADSB's Difficulties With State And Federal Regulators

State and federal regulators first uncovered irregularities at ADSB during a routine examination begun in late 1983, approximately six months after Sahni acquired the savings and loan. Stip. ¶ 37; E.R. 2628. In the course of a joint examination, FHLBB examiners and the California Department of Savings and Loan discovered that ADSB had loaned $82.7 million in excess of certain state lending limits (E.R. 1691), had failed to submit required financial reports on a timely basis, and was guilty of "pervasive accounting deficiencies [that] could be an indication of unsafe and unsound practices." E.R. 1692.

On June 20, 1984, the FHLBB and ADSB executed a Supervisory Agreement. This Agreement, which was not a public document, required, among other things, that the thrift limit its loans to any one borrower, dispose of all loans in excess of these limitations, and maintain accurate and complete records. Stip. ¶ 40; E.R. 186-89. On October 4, 1984, state regulators and ADSB executed a consent order, also not publicly available, that required ADSB to maintain a net worth of at least 5% of its total assets, and to limit investments in subsidiary service corporations to 60% of its total assets. Stip. ¶ 44; E.R. 216.

Regulators soon learned, however, that ADSB was continuing to violate its regulatory obligations. In a confidential letter dated January 18, 1985, the FHLBB noted that the thrift's "sizable loans" to subsidiaries were "in direct violation" of the limitation on loans to one borrower. E.R. 246. The FHLBB also expressed alarm about ADSB's investment and lending practices, which it found "clearly expose[d] the institution to significant interest-rate and funding risks" and could result in "material adverse effects on its financial condition." E.R. 243. Noting "numerous regulatory violations" that examiners had observed, the FHLBB sought assurances from the thrift's auditors, Touche Ross, that ADSB was complying with the accounting requirements of the Supervisory Agreement and applicable regulations. E.R. 245, 247.

These assurances, however, were not forthcoming. Instead, in April 1985, Touche Ross advised ADSB that it had improperly recognized income tax benefits of nearly $6 million and had improperly deferred recognition of financial futures losses of nearly $19 million, and that proper accounting and adjustments to reflect these and other losses would reduce the thrift's net worth to less than zero. Stip. ¶¶ 59-60; E.R. 302.

ADSB responded by discharging Touche Ross in late April and replacing it with Arthur Young. Stip. ¶ 65. ADSB explained the change on the ground that Touche Ross was too expensive. Stip. ¶ 66. In addition, the thrift's Vice President of Finance, James Miller, assured Arthur Young that weaknesses Touche Ross had identified in ADSB's accounting controls had been "substantially corrected" and that "the accounting records of [ADSB]

and its subsidiaries can be relied upon." E.R. 295. Although one month earlier Miller had advised Sahni, Day, and Pope that the thrift was violating its subsidiary investment limitation and net worth requirement, had suffered large losses, and would probably have to make "[l]arge audit adjustments" (Stip. ¶ 55), he did not apprise Arthur Young of these problems. E.R. 295-96.

Touche Ross responded to its dismissal by writing a series of letters, dated May 3, 1985, to state and federal regulators, Sahni, and ADSB's outside counsel, Rogers & Wells, detailing regulatory violations in ADSB's accounting practices and stating that ADSB was, in all probability, insolvent. In its letter to the FHLBB, with copies to state regulators, Rogers & Wells, and Sahni, Touche Ross stated that "the current trend of operations . . . threaten[s] the continued viability of the [bank]," and that, properly calculated to reflect unrecognized losses, ADSB's net worth was "reduced to below zero." E.R. 302. The firm reiterated its concerns and conclusions in separate letters to Sahni and Rogers & Wells, with copies to state regulators and the FHLBB.[4]

Despite these warnings, regulators did not close the thrift. Instead, in a confidential letter dated May 29, 1985, the FHLBB advised ADSB that it viewed the thrift's real estate investments as "unsafe and unsound" and directed it "to cease all such investment immediately." E.R. 982. The FHLBB also commenced new appraisals of ADSB's real estate holdings. Stip. ¶ 57.

3. The Private Placement Memoranda Prepared By Rogers & Wells

During 1985, ADSB issued four PPMs to real estate investors. Rogers & Wells assisted in the preparation of the first two; petitioner, the latter two.

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[4] Touche Ross's letter to Sahni noted that the bank "has a deficiency in assets" that threatened its "continuing viability." E.R. 303. It recommended that ADSB consult with legal counsel concerning how to disclose these facts "to all pertinent parties," and forwarded a copy of the letter directly to Rogers & Wells. E.R. 304.

The first of these PPMs, which ADSB issued in connection with its Vineyard Way syndication, was in circulation at the time ADSB fired Touche Ross. On May 3, 1985, Touche Ross advised Rogers & Wells and Sahni that it was withdrawing its financial reports from the Vineyard Way PPM. E.R. 980. Touche Ross explained its belief that, although a wholly owned subsidiary, rather than ADSB, was serving as the general partner for this syndication, the syndication ultimately depended on the thrift for operating funds. *Id.* Accordingly, Touche Ross concluded that ADSB's "significantly deteriorating condition" prevented the firm from providing an unqualified opinion for the Vineyard Way PPM. *Id.* Touche Ross further stated that, in its view, the Vineyard Way PPM should disclose ADSB's current financial conditions. *Id.*

Notwithstanding Touche Ross's views, Rogers & Wells' revisions to the Vineyard Way PPM contained no disclosure concerning ADSB. Instead, the revised PPM issued on May 10, 1985, contained a financial statement dated March 31, 1985, that Arthur Young had audited, for the wholly owned ADSB subsidiary that was the general partner. *Id.* Like the prior version, the revised PPM provided no information concerning ADSB's financial condition. Although Rogers & Wells initially required that investor funds be held in escrow (Stip. ¶ 99), it authorized disbursement after receiving a letter dated July 8, 1985, from James Miller representing that ADSB had recorded gross profits of over $28 million on real estate transactions during the month of June, leaving it with a net worth of nearly $36 million. Stip. ¶ 103; E.R. 986-87. Miller based these figures on representations by Sahni, Day, Pope and ADSB's General Counsel, Gary Hinman, who each submitted a sworn declaration that the information was accurate and that he was unaware of any communication with regulators during the prior three months "questioning or expressing concern about the continuing viability of the Bank." E.R. 987, 991-94.

In fact, the representations from the ADSB officials upon which Rogers & Wells relied were false. In an audit completed in October 1986, Arthur Young found that, as of June 30, 1985, ADSB had a negative net worth of approximately $23 million. Stip. ¶ 203. Moreover, many of the June real estate transactions were sham sales that involved little or no down payment and were designed to provide a paper profit to offset ADSB's mounting losses. Stip. ¶¶ 74-75, 94-96. As a consequence, after the FHLBB appointed the FSLIC conservator, the FSLIC rescinded the Vineyard Way transaction. Stip. ¶¶ 207-08.

After closing the Vineyard Way transaction, ADSB issued a PPM for its Hickory Trace syndication. Like the Vineyard Way offering, the August 1 Hickory Trace PPM was prepared by Rogers & Wells; the PPM contained Arthur Young's March 31, 1985 audited financial statement for the ADSB subsidiary serving as general partner; and the PPM did not contain an audited statement for ADSB itself. Stip. ¶¶ 105, 106, 109.

In the weeks following issuance of the Hickory Trace PPM, Rogers & Wells attorneys who were working on a wide variety of different matters, including an audit inquiry, were apprised by ADSB officers and Arthur Young personnel of additional information concerning the bank's financial and regulatory problems. See E.R. 891-92, 910-28, 954-59. Following these disclosures, Rogers & Wells required ADSB to issue a revised, or "stickered," PPM for Hickory Trace, dated October 7, 1985, which provided that the transaction could not close unless an audited financial statement for ADSB was completed prior to the closing date. Stip. ¶¶ 115, 117. In December 1985, the Hickory Trace PPM was withdrawn and the investor funds returned. Stip. ¶ 118.

4. The Private Placement Memoranda Worked On By Petitioner

Shortly before Rogers & Wells required a "sticker" for the Hickory Trace PPM. ADSB decided to hire new counsel to handle two new syndications—Wells Park and Gateway Center. ADSB's General Counsel, Gary Hinman,

whom the FDIC later sued for concealing facts as part of an "unlawful conspiracy" to defraud investors in these two partnerships (E.R. 3060, 3073, 3075-76), explained that Rogers & Wells was too expensive. E.R. 3251. After interviewing a small number of firms, ADSB retained petitioner in mid-September for the limited purpose of assisting with the two new syndications. Petitioner was given a copy of the August 1 Hickory Trace PPM, which did not contain the "sticker," as a model for its work on the new syndications. Stip. ¶ 137.

It is undisputed that, prior to the federal take-over of ADSB, petitioner, unlike Rogers & Wells had no knowledge of ADSB's insolvency or valuation problems; the "stickered" Hickory Trace PPM; the May 3, 1985 letters that Touche Ross sent to state and federal regulators, Rogers & Wells and ADSB; or any of the correspondence and orders from state and federal regulators, all of which were unpublished (and, in the case of the FHLBB, confidental). E.R. 3316-17. Petitioner was insulated from such knowledge because no one at ADSB advised Rogers & Wells, Arthur Young, Touche Ross, or the FHLBB that ADSB had retained petitioner. Stip. ¶ 149. Indeed, ADSB retained a new accounting firm, Coopers & Lybrand, in late September 1985 to provide accounting services for the two transactions. Stip. ¶¶ 136, 147. This second change in auditors occured after James Miller advised Sahni, Day, and Pope, in early September, that the FHLBB had contacted Arthur Young to arrange a private meeting with the firm to discuss, among other things, a reappraisal of the Wells Park property. E.R. 1665.

ADSB issued the Wells Park PPM on October 17 and the Gateway Center PPM on November 25, 1985. Stip. ¶¶ 139, 150. Like the "unstickered" August 1 Hickory Trace PPM upon which they were based, the two PPMs petitioner helped prepare did not include an audited financial statement for ADSB. Instead, all three PPMs included copies of the March 31, 1985 statement audited by Arthur Young for the ADSB subsidiary that was the

general partner for both syndications. Stip. ¶¶ 143, 160. Arthur Young had never withdrawn its certification for this statement. Stip. ¶ 90. The Wells Park and Gateway Center PPMs also included financial and tax projections that Coopers & Lybrand prepared. Stip. ¶¶ 136, 147. These offerings were closed by ADSB on December 31, 1985, without participation by petitioner. E.R. 120, 124.

In preparing its tax opinion letters for these two PPMs, petitioner wrote to ADSB's director of syndications, Jeffrey Zoldos, setting forth the assumptions and representations from ADSB upon which petitioner had relied—including the representation that the PPM and its exhibits "are true and accurate in their entirety and [petitioner] may rely on them." E.R. 2516, 2524. Petitioner asked Zoldos if he was "aware of facts which could make any of the representations and assumptions . . . inaccurate." E.R. 2513, 2521. Although Zoldos was responsible for overseeing the legal and accounting work for the institution's syndications (E.R. 1399) and was knowledgeable about the Hickory Trace offering (Stip. ¶ 18), he made only minor corrections to the letters (*e.g.*, E.R. 2514, 2523), and did not reveal that the August 1 Hickory Trace PPM had been "stickered." In addition, ADSB made no change to representations concerning the value of the Wells Park property (see E.R. 2514), despite the fact that, eight days before petitioner wrote to Zoldos concerning the Wells Park PPM, FHLBB examiners had met with James Miller and Arthur Young personnel to advise them of valuation problems and other improprieties with respect to the Wells Park property and eight other ADSB investments. E.R. 1679A-1682.

5. Seizure Of ADSB And Initiation Of This Litigation

The meeting of FHLBB examiners with Miller and Arthur Young in early October followed shortly after a confidential September 18th letter to ADSB in which the FHLBB expressed serious concerns "regarding the condition and operations of [ADSB] and its service corporations." (E.R. 1705).[5] Thereafter, a succession of regulatory actions eventually led to the appointment of a conservator for the institution in February 1986. On November 22, 1985, state regulators advised ADSB that it was in violation of the 5% net worth requirement. Stip. ¶ 163. One week later, the FHLBB met with Sahni, Day, and ADSB's outside regulatory counsel[6] in an attempt to execute a new Supervisory Agreement. Stip. ¶¶ 163-64. ADSB refused to enter into any such agreement. Stip. ¶ 164. On December 13, state regulators issued a cease-and-desist order that restricted ADSB's investments in its subsidiaries and prohibited it from increasing its savings balance after January 1, 1986 unless it first submitted its overdue audited financial statement for 1985. Stip. ¶¶ 170-172. On December 17 and 19, the FHLBB directed ADSB to reduce its reported net worth by over $17 million. Stip. ¶¶ 173, 174.

Finally, on December 20, 1985, the FHLBB imposed severe operating restrictions on ADSB that were to remain in place until auditors confirmed that the bank had met its net worth requirements. Stip. ¶ 175. The very day the FHLBB imposed these restrictions, federal regulators learned of the two Wells Park and Gateway Center transactions, which were scheduled to close on December 31, 1985. Stip. ¶ 149. Although ADSB refused to provide additional information about these offerings, the regulators never contacted petitioner before the closing date. They also took no steps to prevent the scheduled closing, both of which took place on December 31. See

[5] By its letter of September 18th, which petitioner was never given, the FHLBB forwarded a report that showed that the thrift's net worth was unlikely to meet the 5% requirement established by state regulators; that the thrift's recognition of future losses would cause "a significant impairment of the institution's net worth"; and that the thrift's loans to syndications were "unsafe and unsound." E.R. 1709-28.

[6] Throughout the relevant period, the law firms of Leff & Mason and Fried, Frank, Harris, Shriver & Jacobson assisted ADSB in its dealings with state and federal regulators. Stip. ¶ 134. Petitioner performed no such services for the institution. E.R. 3255.

id. The closing of the Wells Park and Gateway Center transactions violated the December 20 FHLBB directive.[7]

On February 14, 1986, citing ADSB's insolvency, its dissipation of assets, and its "'December 1985 Transactions,' many of which were in violation of supervisory directives" (E.R. 2640), the FHLBB appointed the FSLIC conservator of ADSB and dismissed the thrift's management, including Miller, Zoldos, Sahni, and Day. Stip. ¶¶ 200, 205. On February 19, 1986, the FSLIC brought suit against the latter two, seeking damages in excess of $60 million as a result of their breaches of fiduciary duty, fraud and, in the case of Sahni, RICO violations. Stip. ¶ 206; E.R. 3048.

In October 1986, the syndicated partnerships, now controlled by FSLIC as conservator for ADSB, rescinded the Vineyard Way, Wells Park and Gateway transactions and returned all sums invested, plus interest, to all unaffiliated investors. E.R. 2672-3003. In return, the partnerships received their full interest in the properties that were involved in the syndications. As a consequence, the investors were made whole, and ADSB, its subsidiaries, and the investors were placed in the same position vis-a-vis each other that they would have occupied had there been no closings. The sole exception was that ADSB and its subsidiaries had incurred out-of-pocket expenses—principally brokerage commissions and professional fees—as a consequence of the failed offerings. See *infra* p. 12 and note 10. On December 31, 1986, the FSLIC sued Hinman, seeking approximately $1.5 million in damages for his alleged negligence, fraud, and breach of fiduciary duties in connection with the Wells Park and Gateway Center syndications. See E.R. 3055-88. Nearly two and one-half years later, following its appointment as receiver for ADSB, the FSLIC initiated this action against petitioner.

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[7] Among other things, the FHLBB directive barred ADSB from engaging in any transaction with an affiliate. Stip. ¶ 175.

6. Proceedings Below

The FSLIC, as receiver of ADSB, sued petitioner in the United States District Court for the Central District of California for malpractice under California tort law seeking damages that ADSB suffered as a result of the two rescinded offerings on which petitioner worked. The FSLIC also sued on behalf of the Wells Park and Gateway Center investors.[8] The FDIC alleged that if petitioner had exercised the requisite care, it would have discovered the thrift's true financial condition.

After the FDIC was substituted for the FSLIC as a plaintiff, the district court granted petitioner summary judgment on all of the FDIC's claims. With respect to the investor-assigned claims, the court held that because all investors had been repaid in full, their interests were fully protected and the FDIC therefore had no claims to assert on their behalf. Pet. App. 18a-19a.[9] That ruling is not before this Court.[10]

With respect to the FDIC's claims on behalf of ADSB, petitioner argued that it owed no duty to its client to ferret out information that the client's owners and senior officers already knew and had failed to disclose to petitioner. Imputation of the knowledge of these persons to ADSB, petitioner argued, precluded any recovery by ADSB. Because the FDIC, as receiver, could assert no

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[8] In accepting the rescission offers, investors assigned to the FSLIC whatever rights, if any, they had against petitioner. Complaint ¶¶ 20, 31.

[9] This result reflects both the economic reality that no loss was suffered by any investor and the "one-satisfaction" rule. Under that rule, because the investors had received full compensation, they had no remaining claims to assert against (or assign to) anyone. *See Jaramillo* v. *California*, 81 Cal. App. 3d 968, 146 Cal. Rptr. 823 (1978).

[10] The Ninth Circuit left that ruling intact by limiting the FDIC's damages to the "out of pocket costs to the client [ADSB] properly attributable to the fraudulent transaction." Pet. App. at 15a. Indeed, on appeal, the FDIC did "not seek[] reimbursement for the rescission payments to the investors." *Id.*

greater rights than ADSB, its claims failed. The district court agreed, and granted summary judgment as to these claims as well. Pet. App. 19a.

The Ninth Circuit reversed. Purporting to look to California law as the source of petitioner's duty to its client (Pet. App. 6a-8a), the court of appeals relied on principles derived from federal securities law in determining that this duty included an obligation to investigate representations made by a client's senior officers and owners. *Id.* at 8a-9a. Whether or not petitioner had discharged this duty, the court held, was a question of fact that could not be resolved on summary judgment. *Id.* at 9a.

The Ninth Circuit acknowledged, however, that the existence of an issue as to petitioner's compliance with this duty was not dispositive of whether a viable claim existed. The court accepted the "unexceptionable general principle that the perpetrator of a fraud cannot be a victim of that fraud." *Id.* at 10a. The court further accepted that ADSB's owners and senior officers, Sahni and Day, could not have pursued any claim against petitioner. *Id.* The issues before the court of appeals were whether the wrongdoing of Sahni and Day, and their knowledge of that wrongdoing, were to be imputed to ADSB, their wholly owned corporation, and whether this defense applied to the FDIC as receiver.

The Ninth Circuit decided both issues by creating federal rules of decision that are contrary to California law. See *id.* at 13a (holding that federal law governs "the application of defenses against FDIC"). First, relying solely on federal court decisions, the court reasoned that the knowledge of miscreant owners and officers could not be imputed to ADSB because those insiders had benefited and ADSB's insolvency had been "aggravat[ed]." *Id.* at 12a. Second, the court concluded that, even if imputation to ADSB were proper, federal law precluded defenses against the FDIC based on "the bank's inequitable conduct" because this would "diminish[] the value of the asset pool held by the receiver." *Id.* at 15a.

SUMMARY OF ARGUMENT

I. Where Congress addresses a subject, separation of powers principles require that federal courts not exercise their limited and extraordinary power to create federal common law in order to alter the remedies Congress has adopted. See, *e.g.*, *Northwest Airlines, Inc.* v. *Transport Workers Union*, 451 U.S. 77, 95-97 (1981). Here, Congress has addressed the FDIC's rights as receiver. See 12 U.S.C. § 1821(d)(2)(A). The express language of that statutory provision makes clear that in this case the FDIC as receiver is asserting the rights of the savings and loan. As a receiver, the FDIC asserts ADSB's tort claims subject to preexisting defenses, including petitioner's imputation defense. See, *e.g.*, *Rankin* v. *City Nat'l Bank*, 208 U.S. 541, 546 (1908); *cf. Coit Independence Joint Venture* v. *FSLIC*, 489 U.S. 561, 571, 585 (1989).

Congress understood, as has this Court, that state law governs a federally insured financial institution's tort claims and the defenses thereto. See *Bank of America Nat'l Trust & Sav. Ass'n* v. *Parnell*, 352 U.S. 29, 33-34 (1956). Congress provided the FDIC no special immunity from the state law imputation defense asserted by petitioner. This is important because when Congress believed state law was inadequate, Congress *expressly* created either a federal cause of action or an exception to specific state law defenses. In this instance, Congress did neither.

Finally, Congress expressly adopted the remedies it believed appropriate to regulate the conduct of attorneys who represent savings and loans; it included no federal cause of action for the alleged negligence at issue in this case, however, and instead provided administrative remedies that reach only knowing or reckless misconduct. Any cause of action for, and defenses to, alleged attorney negligence were left to state law. The court below improperly upset the careful balance Congress set forth in the statute by using federal common law to abrogate state-law defenses that Congress left undisturbed.

II. Even if Congress had not specifically addressed the rights the FDIC possesses as receiver of a failed savings institution, the Ninth Circuit still erred in creating a uniform federal rule of decision in this case. The FDIC has not made, and cannot make, the showing necessary to overcome this Court's presumption that state law provides the proper rule of decision. *E.g., United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715, 728-42 (1979).

First, the FDIC does not in fact seek a nationally uniform body of law. Instead, the FDIC routinely bases its claims against attorneys and other professionals on duties created by differing state laws, and seeks only to abrogate those aspects of state law, such as defenses based on imputation, that stand as obstacles to its success. The FDIC's desire for uniform *outcomes* provides no justification for displacing state law. See, *e.g., Kimbell Foods,* 440 U.S. at 729-32; *United States* v. *Yazell,* 382 U.S. 341, 346, 357 (1966). Moreover, here California law applies well-established principles of imputation that are followed throughout the country.

Second, application of state law does not frustrate specific federal objectives. The government's desire to recover more money in civil litigation provides an insufficient basis for judicial creation of a uniform federal rule of decision, particularly because federal financial institution legislation pursues a number of competing social and economic goals. See, *e.g., Kimbell Foods,* 440 U.S. at 735-37, 739 & n.43; *Yazell,* 382 U.S. at 348-49. Indeed, the rule sought by the FDIC impedes important statutory objectives, such as ensuring affordable lending and the availability of professional services at reasonable cost. Congress, not the federal judiciary, is best able to balance the competing policy goals, and, in striking that balance here, Congress provided other mechanisms for protecting the federal fisc.

Finally, the creation of a uniform federal rule of decision here would severely and improperly disrupt commercial relationships that are predicated on state law. See *Kamen* v. *Kemper Fin. Servs.,* 111 S. Ct. 1711, 1717

(1991). Under our system of federalism, tort liability and attorney-client relationships are areas traditionally governed by state law. Lawyers perform services, charge fees, and obtain malpractice insurance on an understanding of their duties and possible liability under well-established state rules. The Ninth Circuit's decision to change those rules years after the services at issue were provided highlights the fundamental unfairness of allowing courts to create uniform federal rules of decision in this area.

ARGUMENT

I. THE FEDERAL COURTS MAY NOT CREATE FEDERAL COMMON LAW TO ALTER THE REMEDIES PROVIDED BY CONGRESS.

A. When Congress Addresses A Subject, There Is No Further Role For Federal Common Law.

This Court has repeatedly held that "once Congress addresses a subject, even a subject previously governed by federal common law, the justification for lawmaking by the federal courts is greatly diminished. Thereafter, the task of the federal courts is to interpret and apply statutory law, *not to create common law.*" *Northwest Airlines, Inc.* v. *Transport Workers Union,* 451 U.S. 77, 95 n.34 (1981) (emphasis added); accord *City of Milwaukee* v. *Illinois,* 451 U.S. 304, 314 (1981). As the Court has explained, "[o]ur 'commitment to the separation of powers is to fundamental' to continue to rely on federal common law 'by judicially decreeing what accords with "common sense and the public weal"' when Congress has addressed the problem." *Id.* at 315 (quoting *TVA* v. *Hill,* 437 U.S. 153, 195 (1978)).[11]

When the Court finds that a statute addresses a subject, the statute then is "the exclusive source of *federal* law"

[11] Indeed, even when there is preexisting federal common law on an issue, which is not the case here, this Court has expressed its "willingness to find congressional displacement of *federal* common law" by a subsequent statute. *City of Milwaukee,* 451 U.S. at 317 & n.9 (emphasis in original).

on the subject. *Id.* at 319 n.14 (emphasis in original). This does *not* mean, however, that state law is preempted. *Id.* To the contrary, the Court has made plain that in situations where federal common law may not be used to supplement federal statutory remedies, state law retains its normal ability to provide such supplementary remedies. See *id.* at 319 n.14, 323-24, 328. In such circumstances, "[a]lthough a federal court may disagree with the . . . approach taken" under state law toward additional remedies, "such disagreement alone is no basis for the creation of federal common law." *Id.* at 323. In this way the Court both respects Congress' preeminent role in promulgating rules of law and the plain dictates of federalism and the Rules of Decision Act, 28 U.S.C. § 1652, which require state law to be followed unless there is a clear federal basis for employing a contrary federal rule.

The Court's decision in *Langley* v. *FDIC*, 484 U.S. 86 (1987), exemplifies the carefully restricted role of federal common law once a federal statute addresses a subject. In *Langley*, borrowers sought to raise a defense to liability on a note based on an unwritten side arrangement. *Id.* at 88-89. Had federal common law applied, the opinion of the Court would have been extremely short because such a secret arrangement fell squarely within the federal common law prohibition of *D'Oench, Duhme & Co.* v. *FDIC*, 315 U.S. 447, 460 (1942), which the FDIC had urged as an alternative ground for affirmance. See *Langley*, 484 U.S. at 92. Instead, the Court stated that the issue was whether the borrowers' secret arrangement constituted an "agreement" under 12 U.S.C. § 1823(e), which had been enacted after *D'Oench*. See *id.* at 90-96. The Court focused exclusively on the statutory provision, refering to *D'Oench* only as an aid in interpreting the statute. See *id.* at 92-93.

In particular, the Court in *Langley* made plain that it would not protect asserted federal interests that were not protected by the language of the statute. First, the Court indicated that if there were fraud in the factum

against the borrower, the FDIC could not acquire "right, title, or interest" under 12 U.S.C. § 1823(e) and thus could not rely on any federal exemption from that defense. *Id.* at 93-94. Second, the Court explained that the FDIC could not avoid an agreement that satisfied the recordkeeping requirements of § 1823(e), "even if the FDIC did not know of" the agreement, regardless of the policy arguments advanced by the FDIC. *Id.* at 95. The Court emphasized: "It would be rewriting the statute to hold otherwise." *Id.*

This Court should begin where *Northwest Airlines*, *City of Milwaukee*, and *Langley* begin, and with what the Ninth Circuit ignored: the statute. Because the statute addresses the subject at issue, the Court's analysis should also end there.

B. Under 12 U.S.C. § 1821(d)(2)(A), The FDIC Succeeds To The Claims Of The Failed Institution.

Congress has enacted an extensive series of statutory provisions applicable to savings and loans and to the FDIC as receiver of savings and loans. See, *e.g.*, 12 U.S.C. §§ 1421-1470, 1811-1834b. This "comprehensive program" of statutory provisions by itself "strongly suggests that there is no room for courts to attempt to improve on that program with federal common law." *City of Milwaukee*, 451 U.S. at 319.

Most specifically, Congress has expressly addressed the nature of the rights possessed by the FDIC as receiver of a savings and loan, and thus the claims the FDIC can assert. Under 12 U.S.C. § 1821(d)(2)(A), which is titled "Successor to institution," the FDIC "as conservator or receiver, and by operation of law, succeed[s] to—(i) all rights, titles, powers, and privileges of the insured depository institution." [12] This provision applies here to

[12] Under 12 U.S.C. § 1821(d)(2)(A)(i), the FDIC also succeeds to "all rights, titles, powers, and privileges . . . of any stockholder, member, accountholder, depositor, officer, or director of such institution with respect to the institution and the assets of the institution." This portion of the statutory provision is not at issue in

the FDIC as successor receiver to the FSLIC.[13]

It is evident from the plain language of § 1821(d)(2)(A) that the FDIC as receiver has succeeded to and thus asserts as its claims the "rights . . . of the insured institution." Indeed, treating the FDIC as a successor also accords with both the natural meaning of "receiver" and prior judicial construction of the rights possessed by a "receiver." It is a well-settled rule of statutory interpretation that "[w]hen Congress codifies a judicially defined concept, it is presumed, absent an express statement to the contrary, that Congress intended to adopt the interpretation placed on that concept by the courts." *Davis* v. *Michigan Dep't of Treasury*, 489 U.S. 803, 813 (1989). When Congress enacted FIRREA, it was established that a federal receiver, including a receiver of a failed savings and loan, "steps into the shoes of the association and takes control of *its* assets." *Coit Independence Joint Venture* v. *FSLIC*, 489 U.S. 561, 571 (1989) (emphasis added); see also *id.* at 585. This Court's decisions have emphasized that, in acting as a successor to a failed institution, a federal receiver is subject to defenses available against that institution. Thus, in *Scott* v. *Armstrong*, 146 U.S. 499, 507 (1892), the Court held:

> The receiver took the assets of the [national bank] . . . , in the absence of statute to the contrary, subject to all claims and defences that might have been interposed as against the insolvent corporation . . . .

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this case as the FDIC does not assert a claim as successor to any of the listed persons. Moreover, pursuant to the phrase "with respect to the institution and the assets of the institution," the FDIC succeeds only to the rights of the listed persons to bring derivative suits to enforce claims of the institution, not to direct claims of the listed persons. *See, e.g., In re Atl. Fin. Fed. Secs. Litig.*, 1991 Fed. Sec. L. Rep. (CCH) ¶ 96,038 (E.D. Pa. 1991).

[13] *See* 12 U.S.C. § 1821a(a)(5)(B). In any event, the statutory provisions applicable in June 1988 stated that the FSLIC as receiver succeeded to the "assets of . . . such association" and the "claims in favor of . . . the insured institution[]." 12 U.S.C. § 1729(b)(1)(A)(i), (d) (1982 & Supp. V).

Accord *Rankin* v. *City Nat'l Bank*, 208 U.S. 541, 546 (1908) (same); *Fourth Street Nat'l Bank* v. *Yardley*, 165 U.S. 634, 653 (1897) (same).[14] In particular, *Armstrong* v. *Ashley*, 204 U.S. 272, 283 (1907), holds that a federally appointed receiver is subject to an imputation defense.

Ignoring this Court's prior rulings on the rights of a receiver, the Ninth Circuit reasoned that the FDIC as a receiver should not be subject to defenses available against the thrift because a receiver, like a bankruptcy trustee, is an involuntary transferee. See Pet. App. 14a. The analogy to a bankruptcy trustee, however, in fact undermines the decision below. This Court has expressly held that when a bankruptcy trustee pursues claims as successor to an insolvent debtor, "[t]he trustee succeeds only to such rights as the bankrupt possessed; and the trustee is subject to all claims and defenses which might have been asserted against the bankrupt but for the filing of the petition." *Bank of Marin* v. *England*, 385 U.S. 99, 101 (1966); *cf. Butner* v. *United States*, 440 U.S. 48, 54-56 (1979) (unless there is an express statutory cause of action, bankruptcy trustee's rights are "defined by state law"; "undefined considerations of equity provide no basis for adoption of uniform federal rule").

That Congress adopted the traditional understanding of the word "receiver" is confirmed by the fact that Congress created a number of *express* statutory exceptions to the rule that the receiver is subject to defenses against

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[14] *See also* 2 R. Clark, *A Treatise on the Law and Practice of Receivers* § 362, at 619-20 (3d ed. 1959) (footnote omitted) ("The Supreme Court of the United States and federal authorities hold that the receiver of a bank stands in no better position than the bank stood as a going concern and when the bank was a party to an illegality, the court will leave the parties where it finds them by refusing relief to the receiver of such a bank."), and cases cited therein; 16 W. Fletcher, *Cyclopedia of the Law of Private Corporations* § 7847, at 542 (perm. ed. 1989) (footnote omitted) (same), and cases cited therein. Similar principles apply when the United States asserts a claim as assignee. *See Guaranty Trust Co.* v. *United States*, 304 U.S. 126, 141-42 (1938).

the institution. Thus, 12 U.S.C. §§ 1821(d)(9) and 1823(e) bar defenses against the receiver based on an agreement of the institution that was either not written or not properly approved and recorded. Section 1821 (d)(14) extends the statute of limitations beyond that period which otherwise still exists under state law. Section 1821(e) allows the receiver to repudiate prospectively certain contracts and precludes claims for specific performance as well as certain damages. And section 1821(k) creates a cause of action against directors and officers for gross negligence, even if the applicable state's law would itself require greater culpability.

In stark contrast to these provisions, Congress did not enact *any* statutory exception to the general rule that the receiver is subject to defenses available against the institution that is applicable to the imputation issue in this case. This omission is particularly important because Congress understood that Section 1821 of Title 12 serves as a "common code" for the rights of the FDIC as receiver. S. Rep. No. 19, 101st Cong., 1st Sess. 313 (1989); see also H.R. Rep. No. 54(I), 101st Cong., 1st Sess. 415 (1989) (1989 amendments to § 1821 are "comprehensive"). It is inappropriate for the federal courts to use federal common law to create a rule of law that Congress has not seen fit to adopt. See *Wallis* v. *Pan American Petroleum Corp.*, 384 U.S. 63, 70 (1966) (congressional enactment of some "statutory defenses" provides "no reason for creating at large a federal common law"); *UAW* v. *Hoosier Cardinal Corp.*, 383 U.S. 696, 703-04 (1966) (where Congress legislates some specific exceptions to state law, Court should not "invent" others); *Walsh v. Ford Motor Co.*, 807 F.2d 1000, 1016 (D.C. Cir. 1986) ("Particularly in an area traditionally in the state's domain, . . . the likelihood is that the national legislature, when it intervenes, and does not say otherwise, opts for the little rather than the much."), *cert. denied*, 482 U.S. 915 (1987).[15]

[15] *Cf. Coit Independence Joint Venture* v. *FSLIC*, 489 U.S. 561, 574 (1989) (because Congress had explicitly given FSLIC adjudicatory authority in its supervisory capacity, it was not "reasonable to infer that . . . Congress intended to confer adjudicatory authority upon FSLIC in its receivership capacity . . ."). Of course, if Congress did pass legislation creating millions of dollars of liability to the government that did not previously exist, serious constitutional questions would be raised if that legislation were to be applied retroactively. *See Perry* v. *United States*, 294 U.S. 330, 350-51 (1935); *Lynch* v. *United States*, 292 U.S. 571, 579-80 (1934).

C. Congress Understood That State Law Governs The Tort Claims Of The Institution.

As shown above, under 12 U.S.C. § 1821(d)(2)(A)(i) the FDIC succeeds to and asserts the claims of the institution. Accordingly, for the FDIC to prevail in its efforts to avoid applicable defenses under California law, the FDIC must convince this Court that federal law governs *the tort claims of the savings and loan itself*. There is no support for this extraordinary expansion of federal law and, indeed, federal court jurisdiction.[16]

To the contrary, Congress understood that state law had traditionally controlled and would continue to govern

[16] Congress has provided for federal court jurisdiction on the basis that the FDIC is a plaintiff. *See* 12 U.S.C. § 1819(b). Of course, "[t]he vesting of jurisdiction in the federal courts does not in and of itself give rise to authority to formulate federal common law." *Texas Indus., Inc.* v. *Radcliff Materials, Inc.*, 451 U.S. 630, 640-41 (1981); *see also Campbell* v. *Haverhill*, 155 U.S. 610, 616 (1895) (Rules of Decision Act, 28 U.S.C. § 1652, applies in federal-question cases). Congress has *not* enacted a provision providing federal court jurisdiction on the basis that a savings and loan is a plaintiff. To the contrary, the removal provision enacted for suits when the FDIC is substituted as a party reflects the understanding of Congress that ordinarily savings and loans will sue in state court. *See* 12 U.S.C. § 1819(b)(2)(B). The application of federal law to ADSB's claims would thus create a whole new class of federal court jurisdiction.

Moreover, three of the plaintiffs here are ADC Financial Corporation (ADCFC), a California corporation, and two partnerships in which ADCFC is the general partner. These three entities were not federally insured and have never been in FDIC conservatorship or receivership. No one has ever contended that federal law applies to their claims and the defenses thereto.

the tort claims of savings and loans. As this Court has recognized, "[e]ven where there is related federal legislation in an area, as is true in this instance, it must be remembered that 'Congress acts . . . against the background of the total *corpus juris* of the states . . . .'" *Pan American Petroleum Corp.*, 384 U.S. at 68 (quoting Hart & Wechsler, *The Federal Courts and the Federal System* 435 (1953)). Tort law is, of course, one of the most traditional areas of state law preeminence. See *Erie R.R.* v. *Tompkins*, 304 U.S. 64, 78 (1938).

In this case, the statutory provisions enacted by Congress reflect Congress' understanding that state law governs the tort claims of savings and loans and their receivers, except when an express federal statutory provision specifies to the contrary. Thus, when Congress enacted a statute of limitations provision, the provision expressly supplemented the limitations period "applicable under State law." 12 U.S.C. §1821(d)(14)(A). Similarly, when Congress provided that the FDIC could bring a federal "gross negligence" claim against directors and officers, Congress both understood that this statutory provision would preempt certain otherwise applicable state laws, see H.R. Conf. Rep. No. 222, 101st Cong., 1st Sess. 398 (1989),[17] and instructed courts to adopt "applicable State law" to define and determine what constituted gross negligence, 12 U.S.C. § 1821(k). The legislative history emphasizes that Congress understood that the preemptive

[17] Numerous other provisions of FIRREA also expressly preempt state law. *See, e.g.*, 12 U.S.C. §§ 1441a(g); 1441b(f)(7); 1463(g)(1); 1467(i)(3); 1787(c)(8)(A) and (E), (e)(1), (f)(1); 1825(a); 1831e(a), (e)(1). None of the statutory provisions preempting state law applies to the issue in this case.

Congress also considered, and the Senate passed, a provision that would have deviated from state law by giving a priority to FDIC claims against "an insured financial institution's director, officer, employee, agent, *attorney*, accountant, appraiser" or other service provider over claims of creditors, depositors, or shareholders. S.774, 101st Cong., 1st Sess., § 214(o) (1989) (emphasis added). The provision was deleted in conference and has never been enacted by Congress.

effect of section 1821(k) "is very limited in scope . . . . [N]or does it represent a major step in the direction of establishing Federal tort standards." 135 Cong. Rec. S4277 (daily ed. April 19, 1989) (Sen. Sanford). And, as previously noted, Congress envisioned that savings and loans would bring tort claims in state courts, not federal courts. See *supra* p. 23 and note 16.

Moreover, when FIRREA was enacted in 1989, it was undisputed that the tort claims by and against savings and loans were governed by state law.[18] Indeed, the great weight of authority held that state law also supplied the rule of decision applicable to the tort claims asserted by federal receivers for failed banks or savings and loans.[19]

Notably, this Court had held that state law, not federal common law, applied to a tort suit by a federally insured

[18] *See, e.g., Astrup* v. *Midwest Fed. Sav. Bank*, 886 F.2d 1057, 1059 (8th Cir. 1989); *FDIC* v. *Braemoor Assocs.*, 686 F.2d 550, 554 (7th Cir. 1982), *cert. denied*, 461 U.S. 927 (1983); *FDIC* v. *Clark*, 1989 U.S. Dist. LEXIS 17556, at *22-*23 (D. Colo. 1989), *aff'd*, 978 F.2d 1541 (10th Cir. 1992); *FSLIC* v. *Frumenti Dev. Corp.*, 676 F. Supp. 957, 962 (N.D. Cal. 1988), *app. dismissed*, 857 F.2d 665 (9th Cir. 1988); *FDIC* v. *Blackburn*, 109 F.R.D. 66, 71 (E.D. Tenn. 1985); *FDIC* v. *Abraham*, 501 F. Supp. 221, 223-24 (E.D. La. 1980).

[19] *See, e.g., FSLIC* v. *Quality Inns, Inc.*, 876 F.2d 353, 359 (4th Cir. 1989) (breach of fiduciary duty); *FSLIC* v. *Capozzi*, 855 F.2d 1319, 1324-25 (8th Cir. 1988) (breach of fiduciary duty), *vacated on other grounds*, 490 U.S. 1062 (1989); *Trigo* v. *FDIC*, 847 F.2d 1499, 1502-03 n.4 (11th Cir. 1988) ("when acting as receiver, the FDIC is governed by state law"); *FSLIC* v. *Ticktin*, 832 F.2d 1438, 1445-46 (7th Cir. 1987), *rev'd on other grounds*, 490 U.S. 82 (1989); *Warner* v. *Central Trust Co.*, 798 F.2d 167, 172 (6th Cir. 1986); *American Nat'l Bank* v. *FDIC*, 710 F.2d 1528, 1540-41 (11th Cir. 1983) (constructive trust); *FDIC* v. *Braemoor Assocs.*, 686 F.2d at 554 (breach of fiduciary duty); *Atkinson* v. *FDIC*, 635 F.2d 508, 511 (5th Cir. 1981) (set-off); *FDIC* v. *Clark*, 1989 U.S. Dist. LEXIS 17556, at *15-*24 (proportionate fault); *FSLIC* v. *Frumenti Dev. Corp.*, 676 F. Supp. at 961-64 (fraud, negligent misrepresentation); *FSLIC* v. *Huff*, 631 F. Supp. 1350, 1354 (D. Kan. 1986) (fraud); *FDIC* v. *Abraham*, 501 F. Supp. at 223-24 (breach of fiduciary duty, laches, contribution); *Jacobson* v. *FDIC*, 407 F. Supp. 821, 827 (S.D. Iowa 1976) (discharge).

savings association for conversion of bonds issued by the Home Owners Loan Corporation and guaranteed by the United States. See *Bank of America Nat'l Trust & Sav. Ass'n* v. *Parnell*, 352 U.S. 29, 33 (1956). The Court did so even though the issues raised by the suit might ultimately affect the federal treasury. *Id.* at 33-34; see also *Coit Independence Joint Venture* v. *FSLIC*, 489 U.S. at 585 (borrower's multi-million dollar claims for savings and loan's alleged torts were "state law claims"); *cf. Miree* v. *DeKalb County*, 433 U.S. 25, 31-32 (1977) (state law applies to entities subject to substantial federal regulation even though a federal common law rule would "advance federal . . . policy by inducing compliance with [regulatory] provisions").

The Court should find that when Congress enacted FIRREA it intended to leave intact the established case law under which tort claims of savings and loans are governed by state law. See, *e.g.*, *Cottage Sav. Ass'n* v. *Commissioner*, 111 S. Ct. 1503, 1508-09 (1991). In its periodic revisions of federal financial institution legislation, Congress has not been reticent expressly to overrule existing judicial doctrines and decisions, including those from lower courts. See, *e.g.*, H.R. Rep. No. 54(I), 101st Cong., 1st Sess. 418-19, 468 (1989); S. Rep. No. 19, 101st Cong., 1st Sess. 384, 386 (1989). Here, no statutory provision overrules the cases holding that the tort claims of savings and loans are governed by state law.

D. Congress Created The Remedies It Deemed Appropriate To Regulate Attorney Representation Of Savings And Loans.

There can be no doubt that Congress knew how to create an express statutory federal cause of action for damages in favor of federal receivers. Indeed, it twice did so for the FDIC for fraudulent conveyances and for gross negligence by directors and officers. See 12 U.S.C. §§ 1821(d)(17), 1821(k). The absence of such a statutory cause of action against attorneys weighs heavily against creating a federal common law remedy that Con-

gress did not enact. See *RFC* v. *Beaver County*, 328 U.S. 204, 209 (1946).

Instead of creating a federal cause of action against attorneys, Congress granted the thrift regulatory agency, the Office of Thrift Supervision (OTS), additional administrative enforcement powers against attorneys. Specifically, Congress provided that if an attorney "knowingly or recklessly participates" in a "violation of any law or regulation," a "breach of fiduciary duty," or an "unsafe or unsound practice," that causes a significant loss to a savings and loan, the attorney becomes an "institution-affiliated party." 12 U.S.C. § 1813(u). Status as an "institution-affiliated party" subjects the attorney to certain administrative remedies, including orders issued by OTS (1) to cease and desist certain actions, (2) removing the attorney from serving as counsel to the savings and loan, or (3) prohibiting the attorney from ever participating in the conduct of the affairs of any federally insured depository institution. *Id.* § 1818(b), (e); see also *id.* § 1813(q)(4). As part of a cease-and-desist order, OTS may require an attorney who engages in reckless or knowing misconduct to "make restitution or provide reimbursement, indemnification, or guarantee against loss" if the attorney was "unjustly enriched" or had a "reckless disregard for the law or any applicable regulations or prior [agency] order." *Id.* § 1818(b)(6)(A).

The administrative remedies adopted by Congress are deliberately narrow in scope. Indeed, in a number of respects the administrative remedies are *narrower* than those available under California law or the common law of other States. Most importantly, before being subject to any administrative action, the attorney must be found to have acted "recklessly," not merely negligently as under California law.[20] And an even more culpable

[20] The legislative history explains that Congress "does not intend to subject attorneys to agency enforcement actions for those good faith activities falling within the traditional attorney-client relationship. Specifically, providing advice in good faith to a client financial institution, by itself, should not lead to an enforcement

mental state is required for the limited forms of monetary relief available under 12 U.S.C. § 1818(b)(6). Finally, the doctrine of vicarious liability does not apply to the law firm that employs the wrongdoing attorney.[21]

It would upset the carefully balanced scheme enacted by Congress if the federal courts, under the guise of federal common law, were to fashion a remedy for conduct that is actionable under neither the administrative provisions of federal statutory law nor the standards of California common law. Congress plainly expected that any supplement to the administrative remedies available against attorneys would come from state law. See H.R. Rep. No. 54(I), 101st Cong., 1st Sess. 467 (1989) (administrative enforcement provisions "in no way affect the ability of the AICPA, State Bar agencies or other State licensing agencies to take disciplinary action or of plaintiffs to bring malpractice cases"). This Court has repeatedly held that it will not use federal common law to supplement the remedies chosen by Congress. See *Halcyon Lines* v. *Haenn Ship Ceiling & Refitting Corp.*, 342 U.S. 282, 285-87 (1952) ("because Congress while acting in the field has stopped short of approving the rule . . . here urged, we think it would be inappropriate for us to do so"); accord *Northwest Airlines*, 451 U.S. at

action." H.R. Rep. No. 54(I), 101st Cong., 1st Sess. 467 (1989); *see also id.* at 392 ("[t]his section limits the exposure of independent contractors").

[21] The report of the House Banking Committee states:

> Concern was also expressed that a banking agency could obtain enforcement orders against a . . . partnership, such as a large . . . law firm . . . . Accordingly, the Committee expects the banking agencies to limit enforcement actions in the usual case to individuals who have participated in the wrongful action, to prevent unintended consequences or economic harm to innocent third parties.
>
> However, the Committee strongly believes that the agencies should have the power to proceed against such entities if most or many of the managing partners or senior officers of the entity have participated in some way in the egregious misconduct.

H.R. Rep. No. 54(I), 101st Cong., 1st Sess. 466-67 (1989).

97-98; *Texas Indus.*, 451 U.S. at 644-45; *City of Milwaukee*, 451 U.S. at 320, 328; *Mobil Oil Corp.* v. *Higginbotham*, 436 U.S. 618, 623-25 (1978). But that is precisely what the FDIC has asked the federal courts to do.

E. Congress Has Balanced The Competing Policies And Did Not Leave The Issues In This Case For Federal Common Law To Resolve.

Congress' decision to leave redress of alleged attorney negligence to state law reflects a number of policy considerations important to Congress. In particular, a number of policy considerations support Congress' decision not to preempt imputation defenses recognized under state law. These considerations include: (1) Principles of federalism counsel respect for state law, particularly in such traditional state-law areas as tort law and the professional responsibilities of lawyers. (2) Principles of fairness and proximate causation counsel that it is reasonable to differentiate between an attorney who fails to discover what the owners and officers of his or her client are hiding and an attorney either who acts with knowledge or whose client's owners and officers are ignorant of the true facts. See *infra* pp. 38-39. (3) There also are a host of adverse consequences that could result from an expansion of professional liability. It will encourage some attorneys to withdraw from representing saving and loans, and others to raise their fees to otherwise unnecessary levels to compensate for the increased risks. It could also cause insurers to refuse to cover an attorney who represents a savings and loan. Those attorneys who remain in the field might well be less careful and scupulous than those who leave. Alternatively, the remaining attorneys might be so worried about their own liability that they would create unnecessary impediments even to sound transactions—thus exacerbating the current credit crunch. *Cf. Pinter* v. *Dahl*, 486 U.S. 622, 654 n.29 (1988) (expanding liability of professionals "risks over-deterring activities related to lawful" trans-

actions). It cannot be disputed that in FIRREA and related legislation, Congress considered to be important a number of these kinds of policy considerations. See *supra* pp. 24-25, 27-28 and notes 20-21; *cf.* 12 U.S.C. § 1821(d)(2)(E) (in realizing "upon the assets of the institution," receiver should have "due regard to the conditions of credit in the locality"); H.R. Rep. No. 54(I), *supra,* at 436, ("The inability to obtain credit at reasonable rates is a major factor in the decline of many communities in our nation."); S. Rep. No. 1482, 89th Cong., 2d Sess. 7 (1966) ("The committee did not wish to take any action which would do violence to the balance between State and Federal functions and responsibilities which underlies the dual banking system and the dual savings and loan system.").

The FDIC's competing policy arguments in favor of supplanting state law should be addressed to Congress, not the courts.[22] It is axiomatic that when, as here, Congress has balanced the competing policies in an area, the federal courts cannot use federal common law to reset that balance. See, *e.g., Northwest Airlines,* 451 U.S. at 98 ("a favorable reaction to the equitable considerations [advanced by a claimant] is not a sufficient reason for enlarging on the remedial provisions contained in these carefully considered statutes"); *Mobil Oil,* 436 U.S. at 623 ("[W]e need not pause to evaluate the opposing policy arguments. Congress has struck the balance for us."); *id.* at 624 ("a desire for uniformity cannot override the statute"). This principle is fundamental to the allocation of powers in our constitutional system. Here, Congress made the policy choice not to craft federal standards of attorney liability for alleged negligence. Instead, 12 U.S.C. § 1821(d), which contains no exception for claims against or defenses of attorneys, requires the

[22] *See, e.g., Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 214 n.33 (1976) (expanding the "hazards" of providing professional services involves "serious policy questions" best addressed by Congress).

application of state law to this case and the reversal of the Ninth Circuit's decision. See *supra* pp. 19-26.

* * *

In sum, Congress has left no room for judicial creation of a federal rule of decision to govern the tort claims of the FDIC as the receiver of a failed thrift. Congress dealt comprehensively with the entire question of failed thrifts and carefully chose to place the FDIC in the traditional and well-understood role of a receiver. Not only is Congress presumed to know the rights and limitations of a receiver recognized under preexisting law, but Congress also repeatedly manifested its actual knowledge as to how state law cabins the extent of a receiver's claims. When Congress found the federal interest to be inadequately protected by state law, Congress dealt directly and specifically with the problem in the statute itself. Congress has acted on the subject at issue in this case, and thus, federal courts may not create new federal common law rules that supplant the rights and remedies—both state and federal—embodied in the statute.

II. UNDER *KIMBELL FOODS,* STATE LAW SUPPLIES THE RULE OF DECISION.

When this Court addresses whether to create a federal rule of decision, a "presumption" exists that state law supplies the applicable rule of decision. *Kamen* v. *Kemper Fin. Servs.,* 111 S. Ct. 1711, 1717 (1991). This presumption rests on the fundamental premise that principles of separation of powers and federalism require that judicial creation of a uniform federal rule of decision be exceedingly rare:

> Federal courts, unlike state courts, are not general common-law courts and do not possess a general power to develop and apply their own rules of decision . . . . The enactment of a federal rule in an area of national concern, and the decision whether to displace state law in doing so, is generally made not by the federal judiciary, purposefully insulated from democratic pressures, but by the people through their elected representatives in Congress.

City of Milwaukee v. *Illinois,* 451 U.S. 304, 312-13 (1981); see also *Wheeldin* v. *Wheeler,* 373 U.S. 647, 651 (1963) (use of federal common law to create a uniform federal rule of decision is limited to "few and restricted" instances).

The Court's reluctance to create a uniform federal rule of decision is properly greatest when, as here, there are substantial policy arguments opposed to the proposed uniform rule. As Justice Harlan wrote for the Court in *United States* v. *Brosnan,* 363 U.S. 237, 251-52 (1960), in assessing whether the pecuniary interests of the United States justified creating a federal rule of decision:

> It must be recognized that the factors supporting a federal rule of uniformity in this field, and those militating against the dislocation of long-standing state procedures, are full of competing considerations. They involve many imponderables which this Court is ill-equipped to assess, on which Congress has not yet spoken, and which we think are best left to that body to deal with in light of their full illumination. A wise solution of such a far-reaching problem cannot be achieved within the confines of a lawsuit. Until Congress otherwise determines, we think that state law is effective . . . .

Similarly, in *United States* v. *Kimbell Foods, Inc.,* 440 U.S. 715 (1979), this Court also declined to resolve conflicting policy arguments, including the government's desire to recover more money, by creating a uniform federal rule of decision. The Court explained:

> Because the ultimate consequences of altering settled commercial practices are so difficult to foresee, we hesitate to create new uncertainties in the absence of careful legislative deliberation . . . . Thus, the prudent course is to adopt the ready made body of state law as the federal rule of decision until Congress strikes a different accommodation.

Id. at 739-40.[23] Accordingly, any analysis of whether to create a uniform federal rule of decision must reflect the Court's respect for both Congress and the States as the principal sources of substantive law, as well as the Court's prudent assessment of the limited capacity of federal courts to make complex policy—indeed, essentially legislative—decisions.

[23] *See also Texas Indus., Inc.* v. *Radcliff Materials, Inc.,* 451 U.S. 630, 646-47 (1981) (the task of resolving conflicting policy arguments, "regardless of the merits of the conflicting arguments, is a matter for Congress, not the courts"); *Halcyon Lines* v. *Haenn Ship Ceiling & Refitting Corp.,* 342 U.S. 282, 286 (1952) ("We think that legislative consideration and action can best bring about a fair accommodation of the diverse but related interests of these groups. The legislative process is peculiarly adapted to determine which of the many possible solutions to this problem would be most beneficial in the long run."); *cf. Bush* v. *Lucas,* 462 U.S. 367, 388-90 (1983) (refusing to add a "new judicial remedy" to remedies Congress has already provided as Congress is in a better position to evaluate and balance conflicting policy arguments).

Kimbell Foods sets forth three basic factors to assist the Court in deciding whether the presumption in favor of state law has been overcome. The Court considers: (1) whether the vindication of federal interests requires a "nationally uniform body of law"; (2) "whether application of state law would frustrate specific objectives of the federal programs"; and (3) "the extent to which application of a federal rule would disrupt commercial relationships predicated on state law." 440 U.S. at 728-29. These standards are framed to minimize significantly the likelihood that the courts will create federal rules of decision. The uniform body of law must be a necessity; the interference must be with discrete and identifiable federal interests; and, even still, state law ought to be employed when the effect of a federal rule would be to frustrate commercial expectations. As applied to this case, all three of these factors conclusively favor state law.

A. There Is No Need For The Federal Courts To Create A "Nationally Uniform Body Of Law."

1. The FDIC's request that this Court create a uniform federal rule of decision concerning imputation defenses to attorney malpractice claims fails at the thresh-

old. This is because the FDIC itself relies on what it asserts is favorable California *state* law on the issue of the existence and extent of the duty of investigation that an attorney owes to its client. Thus, the FDIC does not genuinely seek "a nationally uniform body of law," *id.* at 728; rather, the only uniformity in the FDIC's position is its desire to prevail in all cases.

This Court's decisions emphasize that a federal agency's reliance on substantive state law on some issues "belie[s] [its] assertion that a federal rule . . . is needed to avoid the administrative burdens created by disparate state" laws. *Kimbell Foods,* 440 U.S. at 731-32; see also *id.* at 729-31; *United States* v. *Yazell,* 382 U.S. 341, 346, 357 (1966) (government's own use of state law on some issues is "intensely material" to rejection of government's request for uniform federal rule of decision on other issue); *cf. RFC* v. *Beaver County,* 328 U.S. 204, 209 (1946) (where part of regulatory scheme relies on state law, "assumption" that uniformity is necessary cannot be made). Here, at the FDIC's urging, the Ninth Circuit appeared to find in California law a unique duty of a lawyer to make a broad investigation for the benefit of his or her client into the very facts falsely represented to the attorney by the client. See Pet. App. 6a-9a. Such a duty, even if it exists under California law, which is doubtful,[24] is certainly a pro-plaintiff rule that goes well

[24] The Ninth Circuit's decision is contrary to the principles of the most analogous California decisions. *See Blain* v. *Doctor's Co.,* 222 Cal. App. 3d 1048, 1063-64, 272 Cal. Rptr. 250, 258-59 (1990) (a client may not sue an attorney for the consequences of the client's false statements); *Bily* v. *Arthur Young & Co.,* 3 Cal. 4th 370, 397-98, 404-06, 834 P.2d 745, 761, 766-67 (1992) (refusing to expand professional liability because benefits are dubious but increased costs and decreased availability of services are probable). It is also contrary to (1) generally recognized ethical standards, *see* A.B.A. Model Rules of Professional Conduct, Rule 2.1 cmt. (1983) ("A lawyer ordinarily has no duty to initiate investigation of a client's affairs"); *Fortson* v. *Winstead, McGuire, Sechrest & Minick,* 961 F.2d 469, 474 (4th Cir. 1992) (ABA's standard "permits an attorney to assume that the facts related to him by the client are accurate, so long as he has no knowledge

beyond any duty imposed by FIRREA, see *supra* pp. 27-28, applicable ethical rules, or the common law in other states, see *supra* p. 34 and note 24.[25]

that would raise suspicion"); *Stokes* v. *Lokken,* 644 F.2d 779, 783 n.3 (8th Cir. 1981) (ethical standards do not impose duty on attorney to investigate information supplied by client); and (2) the common law of sister states, *see, e.g., Milliner* v. *Elmer Fox & Co.,* 529 P.2d 806, 808 (Utah 1974) (dismissing action against attorney who prepared SEC filings: "As a general rule, an attorney is not required to investigate the truth or falsity of facts and information furnished by his client, and his failure to do so would not be negligence . . ."); *Hangman Ridge Training Stables, Inc.* v. *Safeco Title Ins. Co.,* 652 P.2d 962, 966 (Wash. Ct. App. 1982) (Attorneys do not have "an obligation to make extensive inquiries into [clients'] personal or financial conditions . . . . Otherwise, there would be no possible limit on the advice attorneys would be required to give."); *Friedman* v. *Dozorc,* 312 N.W.2d 585, 605-06 (Mich. 1981) ("A lawyer is entitled to accept his client's version of the facts and to proceed on the assumption that they are true absent compelling evidence to the contrary."); *Pacelli* v. *Kloppenberg,* 382 N.E.2d 570, 571 (Ill. App. 1978) (when an attorney does not have a "reason to question the honesty" of a fiduciary and agent of the client, the attorney has no duty of "investigation" regarding that fiduciary); *Bryan & Amidei* v. *Law,* 435 S.W. 2d 587, 593 (Tex. Civ. 1968) ("an attorney has a right, in good faith, to advise and act upon the facts which he gets from his client, and it is not his duty to go elsewhere for information").

[25] The Ninth Circuit's analysis demonstrates the hazards of mixing and matching state and federal law. The Ninth Circuit relied exclusively on interpretations of federal securities law as support for the duty it purported to find under California law. First, the Ninth Circuit relied on two outdated and inapposite district court decisions interpreting Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*. *See* Pet. App. 8a. Section 12 of the Securities Act is an inappropriate guide to a state common law suit by an issuer of securities against its lawyer because: (1) Lawyers whose involvement, as here, is "the performance of their professional services," are not proper Section 12 defendants. *Pinter* v. *Dahl,* 486 U.S. 622, 651 & n.27 (1988). (2) Section 12 defines duties between a purchaser of securities and a defendant, *see Pinter,* 486 U.S. at 641; Section 12 does not define any duties owing to a seller or issuer of securities, such as ADSB, *see, e.g., Glusband* v. *Fittin Cunningham Lauzon, Inc.,* 582 F. Supp. 145, 149-50 (S.D. N.Y. 1984) (receiver of issuer). *Cf. Bily,* 3 Cal. 4th at 396-98, 834 P.2d at 760-61 (emphasizing that tort liability requires breach

The FDIC thus seeks to mix and match (1) aspects of putatively favorable state law with (2) judge-made uniform federal rules of decision applicable to other issues whenever state law turns unfavorable. The result is a hybrid claim recognizable under neither California law nor federal law. See *supra* pp. 26-28. The FDIC seeks no uniformity of law, only a uniformity in results. This is exactly the kind of approach that *Kimbell Foods* and other cases forbid.

Nor is the government's heavy reliance on favorable state law limited to this case. The government routinely brings claims against attorneys, accountants, directors, and officers based on asserted breaches of state-law duties.[26] Indeed, the government principally uses local private law firms, not agency counsel or officials, both to investigate and litigate such claims. See *FDIC* v. *Jenkins,* 888 F.2d 1537, 1540 n.4, 1544-46 (11th Cir. 1989) (FDIC official concedes that the FDIC does not investigate institution's potential tort claims at time of federal takeover).[27] Ob-

of a duty owed to the particular plaintiff). (3) In certain respects, the rules imposed by Section 12 are broader than those that exist under the common law. *See Pinter,* 486 U.S. at 641 n.18, 647-48 n.23, 652.

Second, the Ninth Circuit selectively quoted from H. Bloomenthal, *Securities Law Handbook,* § 27.02, at 1096 (1990-91 ed.), omitting the portion that states Bloomenthal is merely repeating a "view" of the SEC expressed in a 1962 administrative release. *Id.* More recent authority from the SEC holds that an attorney may rely on information supplied by a client's officers unless the attorney has "knowledge" that the information is false. *In re Carter,* 1981 Fed. Sec. L. Rep. (CCH) ¶ 82,847, at 84,167-68 (SEC 1981).

[26] The FDIC and the RTC have relied on state statutory causes of action, as well as favorable state common law. *See, e.g.,* Complaint ¶¶ 94-96, *FDIC* v. *Nathan,* No. H-91-2845 (S.D. Tex., filed Sept. 25, 1991) (Texas Deceptive Trade Practices Act); Complaint ¶¶ 82-84, *RTC* v. *Emerald Homes L.P.,* No. Civ-92-1785PHX-RMB (D. Ariz., filed Sept. 21, 1992) (Arizona RICO statute); Complaint ¶¶ 127-28, *RTC* v. *Dean,* No. Civ-92-030PHX-RCB (D. Ariz. filed Feb. 14, 1992) (Arizona illegal dividend statute).

[27] In this case, for example, the FSLIC and the FDIC have paid a California law firm over $8.1 million to investigate and

viously, these private law firms have an intimate familiarity with applicable state tort law, and its application creates no administrative burden for them. Because the government does not genuinely seek uniformity, the government can find no support in the first *Kimbell* factor.

2. Even if FDIC sought a "nationally uniform body of law," the interest asserted in this case would still be a minimal one because the "difference between the rules" followed in the states on imputation and the defenses available against a receiver "are insignificant in comparison with the similarities." *Kimbell Foods,* 440 U.S. at 732 n.28. California law requires imputation when "the agent is in fact acting for his principal in the transaction, even though he may have an opposing personal interest." *McKenney* v. *Ellsworth,* 165 Cal. 326, 329, 132 P. 75, 76 (1913). In *McKenney,* the president of a bank sold a note to the bank knowing that there had already been an offsetting payment. The president "conducted the affairs of the bank" and acted as both seller "and the agent who was consummating the purchase on behalf of the bank." *Id.* at 329-30, 132 P. at 76. When the receiver for the failed bank sued for payment of the note, the court upheld an imputation defense even though the president had benefited and the bank had lost money. *Id.*

California law requires imputation based on at least two sets of circumstances present in this case. First, California law requires imputation when the agents with knowledge are persons who "controlled the management, policies, and affairs of [the] corporation[]." *West American Finance Co.* v. *Pacific Indem. Co.,* 17 Cal. App. 2d 225, 228, 61 P.2d 963, 965 (1936). In *West American Finance,* the agents with knowledge owned a majority of the corporation's stock and controlled its activities. *Id.* They engaged in a series of fraudulent loans, purchases,

litigate claims, principally those against ADSB's owners and senior officers. E.R. 3123-24. Just in the two years 1991 and 1992, the FDIC and the RTC paid outside law firms over $1.5 billion. *See* Nat'l L.J., March 22, 1993, at 3.

and false book entries that caused "large financial losses" to the corporation. *Id.* at 229-33, 61 P.2d at 965-67. The court held that the knowledge of these controlling persons "of their own fraudulent transactions was imputed to the corporation itself, even though [they] were beneficially interested in the frauds so consummated, to the detriment of the corporation." *Id.* at 236-37, 61 P.2d at 969; accord *William* v. *Hasshagen*, 166 Cal. 386, 393, 137 P. 9, 12 (1913) (imputing knowledge of agent who controlled policy and management and holding that "it makes no difference that he took some personal benefit from the fraud"). The present case provides even stronger grounds for imputation under California law than did *West American Finance*. Here, Sahni and Day owned 100% of ADSB's stock and even the FDIC has stated that they had "complete control" of ADSB and its subsidiaries. *Supra* p. 2 and note 3. Sahni and Day had knowledge of all of the information petitioner was allegedly negligent in failing to uncover. See *supra* pp. 2-12.

Second, California law requires imputation for agents with responsibility for a particular transaction, even when they do not control the corporation as a whole. See, *e.g.*, *Rhinock* v. *Price*, 218 Cal. 403, 407, 23 P.2d 1014, 1016 (1933) (knowledge of car salesman who fradulently obtained possession of customer's car is imputed to dealership, despite salesman's adverse interest); *Maron* v. *Swig*, 115 Cal. App. 2d 87, 90-91, 251 P.2d 770, 772 (1962) (superintendent of building used his access to steal property from tenants); *State Sav. & Commercial Bank v. Winchester*, 25 Cal. App. 691, 695, 145 P. 171, 172-73 (1914) (secretary of bank). Here, the agents of ADSB who were responsible—both for the transactions that improperly inflated ADSB's reported net worth and for the later Wells Park and Gateway Center transactions on which petitioner worked—knew the very information that petitioner allegedly negligently failed to uncover. See *supra* pp. 2-12.

As applied to a case such as this, the law of imputation followed in California reflects fundamental principles of

fairness and proximate causation.[28] This is illustrated by the analogous case of *Flagg* v. *Seng*, 16 Cal. App. 2d 545, 60 P.2d 1004 (1936). In *Flagg*, a bankruptcy trustee sued outside professionals (auditors) for alleged negligence in failing to conduct a more diligent investigation to discover false records and improper transactions. The controlling directors of the failed corporations had known the true facts. *Id.* at 551, 60 P.2d at 1007. The court held that this knowledge demonstrated that nothing done by the outside professionals "had any causal relation to" the losses of the corporation. *Id.* Rather, the controlling directors "were not only not deceived by the audits and reports, but they had intentionally handled the transactions in such a manner as to make them appear on the books [falsely.]" *Id.* Accordingly, the judgment against the bankruptcy trustee was affirmed. *Id.* at 552, 60 P.2d at 1008.

Flagg and *McKenney* also demonstrate that under California law a successor such as a bankruptcy trustee or receiver is subject to an imputation defense. Indeed, under California law, "any defense, good against the original party, is good against the receiver." *People* v. *California Safe Deposit & Trust Co.*, 168 Cal. 241, 246, 141 P. 1181, 1183 (1914); accord *Allen* v. *Ramsay*, 179 Cal. App. 2d 843, 854, 4 Cal. Rptr. 575, 582-83 (1960).

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[28] Labels other than proximate causation have sometimes been given to a state-law imputation defense in this context, including lack of reliance. *See, e.g.*, *FDIC* v. *Ernst & Young*, 967 F.2d 166, 170 (5th Cir. 1992) (lack of reliance). Although the Ninth Circuit chose the label "estoppel" for the defense, the real basis for the defense is a failure of the plaintiff to prove the elements of its claim. That is, when wrongdoing by controlling owners, directors, or officers is imputed to the corporation, the corporation cannot assert injury to a legally protectible interest in a suit against a former outside professional to the corporation. *Cf. Blain* v. *Doctor's Co.*, 222 Cal. App. 3d at 1063-64, 272 Cal. Rptr. at 258-59. Of course, whether federal law displaces a state-law rule depends on the substance of the rule, not its label. *Cf. New York Times Co.* v. *Sullivan*, 376 U.S. 254, 269 (1964).

The rules applied in California on (1) imputation and (2) the applicability to a receiver of defenses available against its insolvent predecessor are well established throughout this country. To the best of our knowledge, every state to address the imputation issue posed by this case has adopted a rule consistent with California's—*i.e.*, that imputation exists when "the agent is in fact acting for his principal in the transaction, even though he may have an opposing personal interest," 165 Cal. at 329, 132 P. at 76—particularly when, as here, the agents exercised control over the corporation or the transactions at issue. State-by-state citations of such decisions are set forth in Appendix A hereto. Indeed, this Court in applying federal law to cases involving the fraudulent procurement of land from the United States has followed such a rule. See *Curtis, Collins & Holbrook Co.* v. *United States*, 262 U.S. 215, 224 (1923) (imputation applied even though agent "was violating his instructions" and the more land the agent fraudulently procured, "the more profit he would make"); *J.J. McKaskill Co. v. United States*, 216 U.S. 504, 515 (1910) (agents controlled corporation).

Similarly, in a pre-*Erie* case on appeal from the courts of the District of Columbia, *Armstrong* v. *Ashley*, 204 U.S. 272 (1907), a receiver of a lending company was held not entitled to recover because the knowledge of the company's agents who intentionally approved a fraudulent loan was "imputed to the company," in whose shoes the receiver stood. *Id.* at 283. The court held that when the defendants were not participants in and had no knowledge of the fraud—as is the case here—"[t]he fact that those agents committed a fraud cannot alter the legal effect of their acts or their knowledge with respect to the company." *Id.*

Armstrong also demonstrates, see also *supra* pp. 20-21, that this Court has followed the rule that, absent an express statutory exception, a receiver is subject to defenses available against its predecessor. This rule is also uni-

formly followed in the States. See, *e.g.*, 10 Am. Jur. 2d *Banks* § 764, at 727 (1963); see also *supra* p. 21, note 14.

In sum, the two rules of law sought by the FDIC—that loss to the corporation bars imputation even where the sole owners and management are acting for the institution and that a receiver is not subject to defenses based on its predecessor's wrongdoing—cannot be justified on grounds of uniformity. If anything, there already exists uniform opposition to these rules.

3. Even if applicable state law rules were more disparate, any virtues of uniformity would have to be balanced against the heavy burdens placed on the federal courts in creating a nationally uniform body of tort law. See *Wallis* v. *Pan American Petroleum Corp.*, 384 U.S. 63, 68 (1966) (Court should consider "the feasibility of creating a judicial substitute" for state law). The FDIC and its sister agency, the Resolution Trust Corporation (RTC), have asked the courts to create uniform federal rules of decision on a wide variety of issues in tort suits, including causation, mitigation, comparative fault, proportionate fault, the effect of settlements, and tolling principles applicable to statutes of limitations.[29] Indeed, the FDIC has candidly conceded in this Court that it seeks "articulation of uniform *rules* of federal law that protect federal receivers against claims and defenses that might have been successful against the institution." Petition for Certiorari, at 5, *FDIC* v. *Shrader & York*, (No. 93-651) (emphasis added). The government has even invoked federal common law in support of the creation of novel causes of action not recognized under applicable state law.[30]

[29] *See, e.g., FDIC* v. *Cocke*, 7 F.3d 396, 400 (4th Cir. 1993); *FDIC* v. *Dawson*, 4 F.3d 1303, 1308-09 (5th Cir. 1993); *FDIC* v. *Ferguson*, 982 F.2d 404, 406-07 (10th Cir. 1991); *RTC* v. *Holland & Knight*, 832 F. Supp. 1528 (S.D. Fla. 1993); *FDIC* v. *Gantenbein*, 811 F. Supp. 593, 595-96 (D. Kan. 1992); *FDIC* v. *Cherry, Bekaert & Holland*, 742 F. Supp. 612, 613-15 (M.D. Fla. 1990); *FDIC* v. *Clark*, 1989 U.S. Dist. LEXIS 17556, at *15-*24.

[30] *See, e.g.*, Plaintiff's Supplemental Response to Defendants' Motion to Dismiss, filed Sept. 18, 1992, at 3, 7, *RTC* v. *Deloitte &*

If the FDIC and the RTC succeed in these arguments, the federal courts will be bogged down for years in determining which issues require uniform federal rules of decision, as well as what those rules should be. This prospect is intolerable both for the already strained federal courts and for the individuals affected by such rulings. *Cf. Kimbell Foods,* 440 U.S. at 739 n.42 (refusing to "[d]evelop[] priority rules on a case-by-case basis").[31]

B. Application Of State Law Would Not Frustrate Specific Objectives Of The Federal Program.

The FDIC has previously contended that state law defenses based on imputation frustrate its ability to obtain maximum recovery. Of course, such a rationale would apply to all state law defenses—indeed, to all the elements of the FDIC's *prima facie* case and even to the requirement of adequate factual proof. This Court has squarely rejected this kind of self-serving argument.

As the Court held in *Robertson* v. *Wegmann,* 436 U.S. 584, 593 (1978),

> a state [law] cannot be considered 'inconsistent' with federal law merely because the [state law] causes the plaintiff to lose the litigation. If success of the . . . action were the only benchmark, there would be no reason at all to look to state law, for the appropriate rule would then always be the one favoring the plaintiff, and its source would be essentially irrelevant.

Touche, (D. Colo.) (No. 92-C-408) (asserting federal common law tort of "spoliation of evidence").

[31] The principal case relied on by the FDIC, *D'Oench, Duhme & Co.* v. *FDIC,* 315 U.S. 447 (1942), is distinguishable concerning uniformity on at least three grounds. First, in *D'Oench,* the FDIC did not rely on state law for some issues and federal law for others. Second, because *D'Oench* was decided prior to promulgation of the Uniform Commercial Code, there was significant disparity in applicable state law concerning when a third party took a note subject to a borrower's secret agreement. *See id.* at 453, 455. Third, the issue in *D'Oench* was discrete and did not threaten to enmesh the federal courts in determining uniform federal rules of decision for a host of other issues.

United States v. *Yazell,* 382 U.S. 341, 348-49 (1966), further holds that the "more money" argument is no more persuasive simply because it is offered by the United States, explaining that the government's desire to recover money

> serves merely to present the question—not to answer it. Every creditor has the same interest in this respect; every creditor wants to collect. The United States, as sovereign, has certain preferences and priorities, but neither Congress nor this Court has ever asserted that they are absolute.

Kimbell Foods also rejected the government's "more money" argument, focusing on two important points. One was that the statutory schemes for the SBA and the FHA provided means other than displacing state law to protect federal financial interests. See 440 U.S. at 735-37. The other was that the statutory schemes embodied policy goals other than maximizing federal recovery of funds. Specifically, the statutes sought to encourage lending that otherwise might not occur. See *id.* at 735-36. The effects of a uniform federal rule of decision on these other policy goals was "difficult to foresee" and might "inhibit private lenders' extensions of credit to the very people for whom Congress created these programs." *Id.* at 739 & n.43. The Court properly refused to do what Congress had not done, *i.e.,* set the balance between the competing policy goals reflected in the statute by creating a uniform federal rule of decision overriding state law. See *id.* at 735 ("We believe that had Congress intended the private commercial sector, rather than taxpayers in general, to bear the risks of default entailed by these public welfare programs, it would have established a priority scheme displacing state law.").[32]

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[32] The Court has previously recognized and applied the larger truth that:

> no legislation pursues its purposes at all costs. Deciding what competing values will or will not be sacrificed to the achievement of a particular objective is the very essence of legislative choice—and it frustrates rather than effectuates legislative

Both of the circumstances in *Kimbell Foods* are present in even greater force here. As in *Kimbell Foods*, the statute provides a number of mechanisms for protecting the federal treasury. These include: (1) Federal regulators periodically (now, annually) conduct an examination of the institution and its assets. See 12 U.S.C. §§ 1464(d)(1)(B), 1820(d). The examiners have complete access to the institution's employees, books, records, and documents. See *id.* § 1464(d)(1)(B)(ii). Indeed, the regulators can take testimony under oath and issue subpoenas. See *id.* § 1464(d)(1)(B)(v). As part of the examinations, the regulators are charged with evaluating the value of the assets of the institution and may order new appraisals or direct additional reserves as appropriate. See, *e.g.*, 12 C.F.R. §§ 563-17.1(a)(1), (b)(1); 563-17.2(b), (c) (1985); see also H.R. Rep. No. 330, 102d Cong., 1st Sess. 99 (1991) (examinations are "[o]ne of the keys to protecting the Federal deposit insurance funds . . ."). In this case, as the Ninth Circuit concluded, "FHLB examiners were investigating ADSB for two years prior to the takeover. The regulators were closely overseeing the thrift and had the ability, either independently or through FSLIC, to uncover the facts and notify ADSB of the discovery." *California Union Ins. Co.* v. *American Diversified Sav. Bank*, 948 F.2d 556, 565 (9th Cir. 1991). (2) The regulators can direct savings and loans to raise both additional capital and the ratio of capital to assets. See 12 U.S.C. § 1464(s). Such private capital "provid[es] a cushion against losses if the institution's condition deteriorates," thus reducing the chance of a loss being borne by the government. H.R. Conf. Rep. No. 222, 101st Cong., 1st Sess. 404 (1989). (3) The regulators can increase a savings and loan's insurance premium to reflect the risks that that institution's

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intent simplistically to assume that *whatever* furthers the statute's primary objective must be the law.

Rodriguez v. *United States*, 480 U.S. 522, 525-26 (1987) (per curiam) (emphasis in original).

activities pose to the insurance fund. See 12 U.S.C. § 1817(b)(1) (B)(i) and (ii). (4) If the condition of a savings and loan deteriorates or if it engages in improper practices, the regulators can limit asset growth, impose cease-and-desist orders, remove management or the directors, terminate federal insurance, or place the institution in conservatorship or receivership. See 12 U.S.C. §§ 1464(d)(2), 1818(a)(2), (b)-(e).

Nothing in this statutory scheme for protecting the federal treasury gives lawyers an affirmative role in carrying out that scheme. To the contrary, the scope of the statute only extends to a lawyer for the institution who "knowingly or recklessly" participates in specified misconduct causing injury to the institution. See 12 U.S.C. § 1813(u). Even then, the statutory remedies do *not* include giving the receiver an express cause of action for damages, divorced from the elements of state law.

Moreover, as in *Kimbell Foods*, the policy goals of the statutory scheme here extend far beyond protecting the federal treasury. In particular, federal legislation provides many economic incentives in order to encourage residential lending, the development of low and moderate-income housing, and the rejuvenation of distressed local real estate markets—all of which might not occur if purely market forces prevailed. See, *e.g.*, H.R. Conf. Rep. No. 222, *supra*, at 413, 417, 421, 429; H.R Rep. No. 54(I), 101st Cong., 1st Sess. 294, 307, 309, 328, 334, 415, 440, 444-46 (1989); see also *supra* pp. 3-4.

Increasing the exposure of lawyers to professional liability will as likely impede these statutory lending objectives. As described previously, *supra* pp. 29-30, many lawyers will cease to represent savings and loans altogether. Less risk-averse attorneys that continue to represent savings and loans may well be less likely to counsel against imprudent transactions. Alternatively, attorneys may become so intimidated that they recommend against even sound transactions at the slightest sign of innovation or risk. At

a minimum, attorneys will raise their fees. This alone may make otherwise profitable transactions uneconomical.[33]

Congress recognized that the expansion of lawyer liability—as with any expansion of liability—is not without its costs. Thus, when Congress addressed the issue of remedies for lawyer misconduct, Congress consciously enacted a provision that "limits the exposure" of lawyers. H.R. Rep. No. 54(I), *supra*, at 392; see *supra* pp. 27-28 and notes 20-21. There is accordingly no basis in the statute or otherwise for using federal comon law, in the purported pursuit of statutory objectives, to expand lawyer liability beyond the parameters that Congress found appropriate.

C. Creation Of A Uniform Federal Rule Of Decision Would Severely Disrupt Commercial Relationships Predicated On State Law.

Respect for federalism has caused this Court repeatedly to refuse to create a uniform federal rule of decision to govern an issue that falls within an area traditionally controlled by state law. See *United States* v. *Yazell*, 382 U.S. at 352 ("Both theory and the precedents of this Court teach us solicitude for state interests."); *United States* v. *Brosnan*, 363 U.S. at 242; *RFC* v. *Beaver County*, 328 U.S. 204, 210 (1946) (Court should apply state law to an issue that is "deeply rooted in state traditions, customs, habits, and laws"). The issue in this case falls squarely within two traditional areas of state law.

First, the case involves tort law. Tort law is, of course, among the most fundamental and traditional areas of state law. See *Erie R.R.* v. *Tompkins*, 304 U.S. 64, 78 (1938).

[33] Again, *D'Oench* is distinguishable. Both *D'Oench* and later decisions emphasize that *D'Oench* involved the borrower's knowing participation in a secret agreement. *E.g.*, *D'Oench*, 315 U.S. at 458-61; *Langley* v. *FDIC*, 484 U.S. 86, 92 (1987); *United States* v. *Yazell*, 382 U.S. at 354. No policy argument could be advanced in favor of such a hidden agreement. The federal interest underlying *D'Oench* is fully vindicated now by 12 U.S.C. § 1823(e). Neither § 1823(e) nor *D'Oench* applies to this case because there is no secret agreement here, nor any knowing participation by petitioner in any illicit conduct.

Second, the issue in this case concerns the regulation of lawyers and the lawyer-client relationship. Again, both history and this Court's precedents teach that the regulation of lawyers and the lawyer-client relationship is preeminently a matter of state law. See, *e.g.*, *Leis* v. *Flynt*, 439 U.S. 438, 442 (1979) (per curiam) ("Since the founding of the Republic, the licensing and regulation of lawyers has been left exclusively to the States and the District of Columbia within their respective jurisdictions. The States prescribe . . . the standards of professional conduct."). Indeed, in enacting FIRREA Congress expressly acknowledged the continuing role for state law in regulating savings and loan lawyers. See H.R. Rep. No. 54(I), *supra*, at 467.

Respect for state law is not merely an abstract preference here. Rather, this Court's deference to state law "is particularly strong in areas in which private parties have entered legal relationships with the expectation that their rights and obligations would be governed by state-law standards." *Kamen* v. *Kemper Fin. Servs.*, 111 S. Ct. 1711, 1717 (1991).

Plainly, a number of private parties have entered a variety of legal relationships with the understandable expectation that state law would govern issues of lawyer liability—including defining the scope of duties and defenses between lawyers and their clients. Based on these reasonable expectations, petitioner and other lawyers have charged ordinary fees, not fees reflecting any premium for the unexpected expansion of professional liability sought by the FDIC.[34] Law firms also contracted for certain amounts of insurance coverage and, in turn, the insurers charged standard premiums—neither the levels of cover-

[34] *D'Oench* again is distinguishable. The law of negotiable instruments, unlike the law governing attorney liability, has long recognized a number of ways in which a transferee takes a claim against the borrower free of certain defenses. *See* 315 U.S. at 458-59. Here, in contrast, no legal tradition suggests that transferees of attorney malpractice claims may take greater rights.

age nor the premiums reflect the FDIC's expanded theories of liability.

It is manifestly unfair to change the applicable legal rules after the fact. As this Court's precedents recognize, the decision to change existing legal rules, especially those grounded in state law, is essentially legislative in nature. Even if the FDIC were correct that the current state-law rules on imputation and lawyer liability presented a serious policy problem, as Justice Harlan wrote for the Court in rejecting a strikingly similar argument:

> A wise solution of such a far-reaching problem cannot be achieved within the confines of a lawsuit. Until Congress otherwise determines, we think that state law is effective . . . .

United States v. *Brosnan*, 363 U.S. at 252.

State law is effective here. Under California law, the decision of the Ninth Circuit should be reversed.

CONCLUSION

The judgment of the Ninth Circuit should be reversed.

Respectfully submitted,

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APPENDIX A

Alabama	*Tatum* v. *Commercial Bank & Trust Co.*, 69 So. 508, 512-13 (Ala. 1915).
Alaska	*Matanuska Valley Bank* v. *Arnold*, 223 F.2d 778, 781 (9th Cir. 1955).
Arizona	*Hughes* v. *Riggs Bank*, 239 P. 297, 298 (Ariz. 1925).
Arkansas	*Little Red River Levee Dist. No. 2* v. *Garrett*, 242 S.W. 555, 557 (Ark. 1922).
Colorado	*Vail Nat'l Bank* v. *Finkelman*, 800 P.2d 1342, 1345 (Colo. Ct. App. 1990).
District of Columbia	*Bowen* v. *Mt. Vernon Sav. Bank*, 105 F.2d 796, 799 (D.C. Cir. 1939).
Florida	*Seidman & Seidman* v. *Gee*, 625 So.2d 1, 3 (Fla. Dist. Ct. App. 1992).
Georgia	*Morris* v. *Georgia Loan, Sav. & Banking Ass'n*, 34 S.E. 378, 383 (Ga. 1899).
Idaho	*California Consol. Mining Co.* v. *Manley*, 81 P. 50, 53 (Idaho 1905).
Illinois	*First Nat'l Bank of Monmouth* v. *Dunbar*, 9 N.E. 186, 188 (Ill. 1886); *Security America Corp.* v. *Schacht*, No. 82-C-2132, (N.D. Ill. Jan. 31, 1983) (available on LEXIS).
Indiana	*Merchants Nat'l Bank* v. *H.L.C. Enter., Inc.*, 441 N.E.2d 509, 514 (Ind. Ct. App. 1982).
Iowa	*Nissen* v. *Nissen Trampoline Co.*, 39 N.W.2d 92, 96-97 (Iowa 1949).
Kansas	*Supreme Petroleum, Inc.* v. *Briggs*, 433 P.2d 373, 378-79 (Kan. 1967).
Louisiana	*Capital Bank & Trust Co.* v. *Broussard Paint & Wall Co.*, 198 So.2d 204, 209 (La. Ct. App. 1967).

Maine	*Meguniicook Nat'l Bank* v. *Knowlton Bros.*, 135 A. 95, 97 (Me. 1926).
Maryland	*Stratton* v. *Sacks*, 99 B.R. 686, 694 n.9 (D. Md. 1989), *aff'd*, 900 F.2d 255 (4th Cir. 1990).
Massachusetts	*Tremont Trust Co.* v. *Noyes*, 141 N.E. 93, 98 (Mass. 1923).
Michigan	*National Turners Bldg. & Loan Ass'n* v. *Schreitmueller*, 285 N.W. 497, 499 (Mich. 1939).
Minnesota	*Sussel Co.* v. *First Fed. Sav. & Loan Ass'n of St. Paul*, 238 N.W.2d 625, 628 (Minn. 1976).
Mississippi	*First Nat'l Bank of Morristown* v. *C.W. Leeton & Bro.*, 95 So. 445, 448 (Miss. 1923).
Missouri	*Newco Land Co.* v. *Martin*, 213 S.W.2d 504, 511-12 (Mo. 1948).
Nebraska	*State* v. *American State Bank of Aurora*, 187 N.W. 769, 770-71 (Neb. 1922).
Nevada	*Bates* v. *Cottonwood Cove Corp.*, 441 P.2d 622, 624 (Nev. 1968).
New Jersey	*Ross Systems* v. *Linden Dari-Delite, Inc.*, 173 A.2d 258, 263 (N.J. 1961).
New York	*Yager Pontiac, Inc.* v. *Fred A. Danker & Sons, Inc.*, 343 N.Y.S.2d 209, 212 (App. Div. 1973).
North Carolina	*Le Duc* v. *Moore*, 15 S.E. 888, 889 (N.C. 1892).
North Dakota	*Dewey* v. *Lutz*, 462 N.W.2d 435, 443 (N.D. 1990).
Ohio	*First Nat'l Bank* v. *Burns*, 103 N.E. 93, 96 (Ohio 1913).
Oklahoma	*Wood & Co.* v. *State ex rel. Johnson*, 80 P.2d 261, 264 (Okla. 1938).

Oregon	*Saratoga Inv. Co.* v. *Kern*, 148 P. 1125, 1128 (Or. 1915).
Pennsylvania	*Citizens' Nat'l Bank of Greencastle* v. *Speck*, 164 A. 810, 811-12 (Pa. 1933).
Rhode Island	*Cook* v. *American Tubing & Webbing Co.*, 65 A. 641, 654-55 (R.I. 1905).
South Carolina	*Crystal Ice Co. of Columbia* v. *First Colonial Corp.*, 257 S.E.2d 496, 498 (S.C. 1979).
South Dakota	*First Nat'l Bank* v. *Harvey*, 137 N.W. 365, 369 (S.D. 1912).
Tennessee	*Griffith Motors, Inc.* v. *Parker*, 633 S.W.2d 319, 322 (Tenn. Ct. App. 1982).
Texas	*Mays* v. *First State Bank of Keller*, 247 S.W. 845, 846 (Tex. Comm'n App. 1923).
Utah	*Evona Inv. Co.* v. *Brummitt*, 240 P. 1105, 1111 (Utah 1925).
Virginia	*State Bank of Pamplin* v. *Payne*, 159 S.E. 163, 165 (Va. 1931).
Washington	*Post* v. *Maryland Casualty Co.*, 97 P.2d 173, 176 (Wash. 1939).
West Virginia	*Knobley Mountain Orchard Co.* v. *People's Bank of Keyser*, 129 S.E. 474, 475-76 (W. Va. 1925).
Wisconsin	*Milwaukee Acceptance Corp.* v. *Dore*, 168 N.W.2d 594, 598 (Wis. 1969).
Wyoming	*American Nat'l Bank of Powell* v. *Foodbasket*, 497 P.2d 546, 547-48 (Wyo. 1972).